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BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. U-0000-94-165

NOTICE OF FILING

The Arizona Utility Investors Association hereby files its comments on the proposed rule for introducing retail electric compeition in Arizona as requested by the Utilities Division on August 28, 1996, in the above-captioned docket.

DATED THIS 12TH DAY OF SEPTEMBER, 1996.

WALTER W. MEEK, PRESIDENT

Original and ten (10) copies of the foregoing Response filed this 12th day of September, 1996, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Copies of the foregoing Response were hand-delivered this 12th day of September,1996, to:

Renz D. Jennings, Chairman
Marcia Weeks, Commissioner
Carl J. Kunasek, Commissioner
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RESPONSE MEMORANDUM

I. Introduction

On August 28, 1996, the Staff of the Commission distributed a draft of a proposed rule to introduce retail electric competition in the state of Arizona and requested comments from the participants in the above captioned docket by September 12. This memorandum is in response to that request.

For the record, the Arizona Utility Investors Association objects strenuously to the abbreviated time for response. After spending two languorous years in Socratic dialogue on this issue, the Staff has suddenly spit out a rule that would revolutionize the electric utility industry and demands responses in eight working days.

We are confronted with a proposed regulation that is simply appalling in its limitations. It sidesteps most legal, financial and technical issues that threaten investors and consumers alike in the transition to competition. The apparent strategy is: if it doesn't work, somebody will fix it later. This rule is so incomplete, it can only be viewed as a political document based on some undisclosed agenda.

Every stakeholder in the electric utility industry should reject this regulation for the following reasons:

Utility Investors Are Victimized
As we will discuss in greater detail, this rule assures that utility owners and investors would lose a substantial portion of their equity. This rule has no binding provisions for recovering stranded investment, and its timing and collection restrictions would make it virtually impossible to achieve full recovery. Under this rule, the State would ultimately confiscate private property belonging to utility investors.

Protracted Legal Action Is Assured
Utility owners and investors cannot let this rule take effect as it is written without using every legal avenue available to prevent it. If this rule should take effect, the State of Arizona (i.e., taxpayers) would be liable, possibly in the billions of dollars, for damage inflicted on utility owners and investors.

All Electric Customers Are Threatened
All but perhaps the largest electricity users would be at risk under this rule for cost-shifting, higher prices and reduced reliability in a disaggregated industry. Even large customers who can protect their own interests in obtaining cost-effective service should be unwilling to accept the uncertainty of their exposure to stranded investment under this rule. As it stands, stranded investment would be handled on an ad hoc basis, and no consumer can predict its impact.

The Rule Spawns Conflict
Good public policy should be designed to move society toward a positive result while minimizing conflicts in which the participants must win or lose. Despite a tumultuous beginning, California's plan for competition has created certainty for the future and resolved major conflicts among the various stakeholders. In contrast, this rule creates uncertainty and an adversarial climate among all interested parties, including investor-owned and public power entities, utility investors, large and small customers, rural consumers and utility employees as they face the multitude of issues which are left unresolved in this rule.

It Produces More Regulation, Not Less
The product of this rule would not be less regulation. This rule promotes "regulated competition" -- the worst of all worlds -- as a permanent feature of the landscape. At the end of the day, the Corporation Commission would have more entities under regulation, more rules to be enforced, more tariffs to approve, more conditions of service, more system charges and more operational mandates than it has accumulated during its history of monopoly regulation. Unlike California, where the Public Utilities Commission is studying a reduced role, the Arizona rule would enlarge the ACC's domain.

Reduced Reliability
The Staff acts as if the Commission can materially influence the reliability of generation and transmission services through the formation of a "working group" on system reliability and by conducting "an inquiry" into pooling and centralized dispatch. This is political positioning. In reality, the Commission has little ability to influence system reliability today and will have less after retail competition is introduced. However, in adopting this rule the Commission can contribute substantially to <u>reduced</u> reliability by undermining the financial stability of the affected utilities and perhaps forcing them to spin off their generation and transmission assets.

II. Specific Investor Concerns

Sec. R14-2-xxx2, Filing of Tariffs by Affected Utilities
Sec. R14-2-xxx4, Competitive Phases
Sec. R14-2-xxx7, Recovery of Stranded Investment of Affected Utilities

Taken together, these sections comprise the overall threat to utility investors. They cannot be separated.

First, it is mystifying that host utilities must file tariffs -- years ahead of competition -- which must encompass bundled and unbundled service for all customer classes while trying to guess at the effects of making 25%, 55% and 100% of their loads subject to competition. What are the market conditions? Who and where is the competition? What are the clearing prices in 1999, 2001 and 2003? These tariffs would give every competitor in America a target to shoot at and plenty of time to aim.

The rule offers no guidelines. Are these tariffs supposed to recover costs, in which case they would be noncompetitive, or is the utility expected to create stranded investment and invite a stockholder derivative action? Should these tariffs reflect the actual costs of distributed service after disaggregation, or are they supposed to maintain the myth of system averaging when it no longer exists? Does each utility play the game differently, or does one size fit all?

We submit that this is a sham requirement designed to avoid evidentiary hearings. This procedure puts all of the affected utilities at risk. Potential competitors are not required to file tariffs until they enter the market which they would choose to do based on whether they can undercut regulated tariffs. The tariff provision should be scrapped in favor of evidentiary hearings to develop procedural guidelines and objectives based on factual and legal findings. That is the job of this Commission.

The competitive timetable combined with a myopic approach to stranded investment virtually assures that full recovery cannot be accomplished, regardless of any ad hoc decisions by the Commission. There is no affirmative commitment to stranded cost recovery anywhere in this rule. There is not even a statement of principle regarding the rights of utility owners. As a matter of law, the first loss of revenue resulting from a departing customer under this rule would constitute an uncompensated taking.

We submit that there is no mathematical way to recover stranded investment on the Staff's competitive timetable. Although we do not know that the full percentage of customer demand available would actually be lost in each phase, we have to assume that it is possible unless the utilities can charge rates that are below cost.

The proposed rule asserts that stranded investment can only be recovered from those who are in the competitive market. That means that 25% of stranded investment would be at issue in 1999, with a maximum of six years for collection; another 30% would come into play in 2001 with four years for collection; and the last 45% of stranded investment would be at issue in 2003 with only two years for recovery. With each increment it would become more difficult (we think impossible) for the Commission to assess an exit fee or some other charge that would be adequate to recover stranded investment.

All studies of stranded investment that we have seen from rating agencies and securities analysts have used 10-year periods for recovery. As a point of reference, independent securities analysts have estimated the combined stranded investment exposure for Arizona Public Service Company and Tucson Electric Power at more than $3 billion. Under the circumstances created by this rule, it makes no sense to establish an arbitrary end date for recovering stranded investment.

Under the Staff timetable, we submit that 100% of a utility's stranded investment would be at issue on January 1, 1999, and the only way to provide recovery would be to assess a non-bypassable competitive transition charge (CTC) across the customer base. This would probably not be necessary if the timetable were extended and competition were phased in according to customer class.

In addition, this rule abrogates the Commission's decision in Docket No. U-1345-95-491 in which APS is permitted to amortize $1.3 billion of regulatory assets over a period eight years ending in 2004. Under the provisions of this rule, APS would lose its ability to internalize regulatory assets in 1999 unless they are converted to a CTC such as the System Benefits Charge.

Apart from the economic morass that this rule would create, the specific provisions for determining stranded investment and providing for its recovery are completely unacceptable. There is no commitment to safeguard the property of utility investors. In fact, all but one of 10 the conditions which the Commission is required to consider in determining stranded investment is either irrelevant or inimical to the interests of shareowners and bondholders. This rule betrays an obvious attitude on the part of Commission Staff that the interests of those who capitalized the utility industry are irrelevant in the march toward competition.

III. Consumer Risks

Every one of AUIA's investor members is also a consumer of electricity, and this rule is as threatening to residential and small business customers as it is to utility investors. There have been no evidentiary hearings to delve into the impacts of competition on ordinary consumers, and the workshops in this docket have produced almost no information about potential benefits or risks to consumers.

In this respect, this rule is simply serendipity. We submit that the Commission Staff hasn't a clue whether residential and small business consumers can prevail in a competition for lower cost electricity or whether, in fact, they may be saddled with higher costs.

In a disaggregated electric industry where no operating guidelines are in place and competing interests are left unresolved, ordinary consumers may confront a quadruple set of risks:

Stranded Investment
We won't belabor the stranded investment issue further. Suffice it to say that when stranded investment is created by the Commission's action and then closeted away for some future consideration, every consumer is ultimately at risk to assume a disproportionate share of the cost.

Cost-Shifting
Cost-shifting will occur on every utility system if customers which are cheaper to serve and which have more attractive load profiles leave the system. This is not only an issue of stranded investment but of making the cost of operating the system more expensive for those who are left on it. Almost by definition, this type of cost-shifting moves from larger customers to smaller ones. This rule would remove 25 percent of each affected utility's load within about two years and another 30 percent two years after that without any analysis of the cost impacts on remaining utility customers.

De-averaging
When utility services are disaggregated (unbundled) as required by the proposed rule, another rate-setting phenomenon will occur: the true costs of service for various customer groups will be exposed. Residential and small business customers will lose the benefit of being averaged in with other customer classes. The higher distribution costs of serving rural customers and those at the fringes of load centers may become factors in pricing electric service. This de-averaging effect will be exacerbated by the departure of large customers from utility systems.

Penalty Pricing
Large industrial and commercial customers, whether they leave the utility system or stay, will have the sophistication and financial ability to adapt to the competitive environment. That's why they want electric competition, because it benefits them. They can accept interruptible power; they can build or pay for backup capability; they can manage their operations to reshape their load profiles; they can buy metering and load management equipment to manage their electricity consumption by the hour and pay for it on the same basis.

The ordinary consumer has no ability to compete in the marketplace for low cost electricity. Neither the utility company nor its customers have the technology in place to allow them to reshape their demand and manage their consumption.

As this industry disaggregates and de-averages, there is every likelihood that ordinary consumers with uneconomic load profiles will have to pay heavy penalties for peak usage. This is a problem that can be mitigated over time and with some investment by the utilities. But once on the slippery slope of competition, the opportunity to prepare customers to fend for themselves may be lost.

Consumer Summary
The Staff may claim that these issues will be resolved in the process of approving the affected utilities' tariff filings. However, we believe it is threatening to the interests of all consumers to commit to separating 50 percent of the utilities' customer base four years from now with no understanding of how consumers will be affected.

IV. Legal Issues

AUIA and other parties to this docket have repeatedly warned the Commission Staff that there are a number of serious legal questions which should be explored on the record before this proceeding reaches the rulemaking stage. We summarized some of these issues most recently in a memorandum which was entered in this docket on August 7, 1996. In proposing this draft rule, the Staff has chosen to disregard these issues entirely.

For the record, we will assert the following:

- This Commission does not have the authority to compel utilities under its jurisdiction to engage in retail competition.
- This Commission does not have the authority to terminate territorial service agreements which it has previously approved.
- This Commission does not have the authority to revoke, amend or abrogate an exclusive certificate of convenience and necessity without legal cause and without providing adequate compensation.
- This Commission does not have the authority to require utility owners and investors to absorb losses related to the imposition of retail competition.

In addition to these ongoing issues, this proposed rule raises new ones:

- As we have stated previously, the rule abrogates the Commission's order in Docket No. U-1345-95-491 relating to the amortization of regulatory assets by APS, an action which would inflict serious and irreparable financial damage on the shareholders of the company.
- Taken together, Sections R14-2xxx3, 2xxx5, 2xxx6 and 2xxx11 appear to be an attempt to extend Commission jurisdiction illegally over the distribution services and rates of municipal entities and political subdivisions such as Salt River Project. SRP states that it intends to create a separate entity to market electricity outside of its service territory, to place that entity under Commission regulation, and to voluntarily open its own service territory to sales by other utilities on a reciprocal basis.

However, the language of this rule would deny customers of SRP the right to participate in retail competition unless SRP agrees to subject itself to the unauthorized jurisdiction of the Commission.

V. Summary

This proposed rule would not further a rational transition to competition. It would confuse and delay it through conflict and litigation. This rule would also harm utility investors and place consumers at risk for higher costs and reduced service reliability. Finally, it would damage the ability of native utilities to raise capital and meet the energy needs of Arizona's expanding economy.

Staff has offered no explanation for the sudden need to adopt a rule without the benefit of hearings or evidence to support its provisions. We see no justification for such haste and much to fear from it. This rule should be shelved. The Commission should set hearings to address the unresolved issues and produce competitive rules that create certainty and reduce risk and conflict.